

## BUSINESS REVIEW

Following the disposal of Christmas festive products and leisure furniture businesses on 23rd August 2002, the Group recorded a turnover of HK\$19.2 million for the year (2003: HK\$502.9 million). If the turnover from these two discontinuing operations for the applicable period prior to the Disposal was not accounted, the comparable turnover for the previous year would be HK\$26.6 million, from which there was a decrease of 27.8% recorded this year. The decrease is reflective of the development stage of the Group's current projects, of which revenues will be booked at their respective completions. The revenue generated from CG animation this year was mainly attributable to licensing revenue in relation to *Zentrix™*, the Group's first CG animation production, and revenue relating to the initial delivery of certain CG animation services for contracting parties.



During the year, the Group incurred a loss of 19.6 million. The loss is mainly attributable to i) a decrease in turnover from the CG animation segment as minimum guaranteed licensing revenue from developed projects were mostly received and accounted in the previous year while current projects are in progress and most revenues have yet to be booked; ii) full year amortisation charges attributable to the Group's developed projects mismatching with the transitional stage of the projects' revenue profile; and iii) the sharing of a pre-tax loss of HK\$10.1 million of Boto International Holdings Limited ("BIHL"), the Group's associate which is engaged in the manufacture and sales of Christmas festive products and leisure furniture.

The financial performance of the Group of the year is representative of the transitional period of the Group's business development, whereas a number of projects are actively being produced. As the corporate brand "Imagi" progressively establishes in the international CG animation industry, a number of leading, world-renowned studios has approached or engaged the Group for business co-operation for CG animation productions for internationally distributed titles.

### CG Animation Pictures

In October 2003, the Group reached a co-production agreement with Bandai, a global leading Japanese toy company, and Toei, a prominent film company in Japan, for the production of a full CG animated direct-to-video feature film titled *Digital Monster X-Evolution*. The story originated from a portable electronic game *Digital Monster* (also known as *Digimon*) developed by Bandai, whose popular game characters were subsequently produced into a popular and long-running TV animation series by Toei and broadcasted at Fuji TV channel in Japan from March 1999 through to March 2001. The direct-to-video CG animation film, a first for the *Digimon* franchise, is 80.5 minutes in length and is directed by Mr. Hiroyuki Kakudou, the director of TV animation series *Digimon Adventure* and *Digimon Adventure 2*. The film is expected to be completed by October 2004 and is scheduled for release in early 2005. Accordingly, revenue from this co-production will be reflected in the annual results for the financial year ending 31st March 2005.

## BUSINESS REVIEW *(Continued)*

### CG Animation Pictures *(Continued)*

In early December 2003, the Group entered into an exclusive agreement with DreamWorks, a top Hollywood animation studio who has won the first-ever *Academy Award*<sup>®</sup> for the Best Animated Feature with *Shrek*<sup>®</sup> and produced the recent box-office record-breaking animated film *Shrek 2*<sup>®</sup>. The agreement engaged the Group for the provision of CG services, including modeling, character animation, lighting, effects, compositing and rendering, in connection with the production of an animated television series *FOTP*, a family comedy series about a pride of white lions who perform in the world-famous Las Vegas act of the illusionists Siegfried & Roy. Starring the voices by the likes of John Goodman and Cheryl Hines, with guests such as Eddie Murphy and Lisa Kudrow getting in on the act, the series comprises an initial run of 13 episodes of half-hour each. The entire series will be completed and delivered to DreamWorks in November 2004 and be broadcasted on the NBC television network in the USA this Fall. Pursuant to the agreement, there is an option for DreamWorks to engage the Group for further production of additional episodes and other optional projects.



CEO Zhang Liping and Deputy Chairman Francis Kao with DreamWorks' Jeffrey Katzenberg during his visit to the Company's Hong Kong studio in April 2004

The Group continued to license the distribution rights over *Zentrix*<sup>™</sup> during this year. In May 2003, licensing agreement was reached with Jade Multimedia International B.V. in connection with the television broadcasting and other ancillary rights in video and merchandising in Asia (except for Japan and Oceanic countries). In November 2003, another licensing agreement was entered with Bandai for the distribution of *Zentrix*<sup>™</sup> in the United States of America and Canada.

### Management Consultancy Services

Turnover generated from the provision of consultancy services by the Group in both Hong Kong and outside of Hong Kong to its associate, BIHL, under a management consultancy agreement was stable and continued to be a healthy source of income for the Group.

## PROSPECTS

Having been aired in France, Japan, Germany and England since September 2002 with encouraging viewers' ratings and received various international awards, including the "Gold Prize Award (Computer Animation)" in the first Hong Kong Digital Entertainment Excellence Awards in May 2003, *Zentrix*<sup>™</sup>, the Group's first 26-episode quality CG animation television series, will premiere in Hong Kong on TVB Jade from 3rd July 2004 at 10:20 a.m. every Saturday. *Zentrix*<sup>™</sup> on DVD has already been available in French since September 2003 and English version DVDs and console game are expected to be released in the USA and Japan respectively in calendar year 2004. The Board expects that, following the TV broadcasting and distributions in most international markets, more royalty and ancillary income will be generated over *Zentrix*<sup>™</sup> for the Group in the ensuing years.

### PROSPECTS *(Continued)*

Looking ahead, the financial year ending 31st March 2005 will be a year full of opportunities. The Group will continue to adopt a balanced strategy encompassing cooperation with international partners and production of our own proprietary titles. The inspiring and exciting production co-operation with world-leading players in the industry like DreamWorks and Bandai ensures stable cash inflow to the Group and takes the Group up along a steep learning curve, sharpening its technology, artistry, skills and knowledge in CG animation production as well as project management, which are all instrumental in elevating the Group to becoming a leading world-class animation studio in the Asia-Pacific region. On the other hand, the Group will also develop its own feature-length animated films so as to capture long-term value in intellectual property rights that can provide significant revenue-generating opportunities in areas including box office, video release and merchandising.

To fund the Group's long-term strategic plan, it has raised a total amount of approximately HK\$74.5 million through a rights issue at HK\$1.08 per rights share (in the proportion of one rights share for every two shares held) in May 2004, which was met with an overwhelming over-subscription of 28.35%.

In addition to its founding success in 3-Dimensional ("3D") CG animation productions, the Group also plans to exploit the profit potential in "Anime", Japan's unique and world renowned 2-Dimensional ("2D") animated film productions. Accordingly, it has evolved its strategic alliance (since June 2002) with Kabushiki Kaisha Mad House ("KK Mad House"), one of the top three Anime studios in Japan and a producer of numerous famous animated films and TV series, including the recent critically acclaimed feature film *Tokyo Godfathers*, into a 15% equity investment in March 2004.



Mr. Shinichi Kobayashi at Imagi Japan

KK Mad House has conducted the pre-production work on the characters, storyboard and scripts of *XS/* (tentative title), one of the Group's proprietary projects. Initially conceptualized as a TV series, the Group is currently in negotiations with a number of distributors for the production of *XS/* as a full CG animation direct-to-video feature film.

In June 2004, the Group opened its second production studio in Chai Wan geared towards its own 2D and 3D feature film productions, including possible joint productions with KK Mad House.

### PROSPECTS *(Continued)*

Marketing of the Group's products is leveraged through the connections of the Group's overseas offices in Los Angeles, USA and Tokyo, Japan with international distributors in the industry. In particular, a number of selected titles currently under pre-production development will be marketed in international film festivals and exhibitions later this year with an aim to further enhance the Group's global industry presence and augment the quality of work and marketing capabilities of the Group through the gathering of market feedbacks.



Mr. Thomas K. Gray and Mr. Galen Howard Walker at Imagi USA

Adding to the enhanced production and marketing capabilities is refreshed management composition through the joining of new board members and senior executives with distinguished international backgrounds and diverse experience in relation to management, film industry and distributions of intellectual property rights. With these strengths, the Board is confident that the establishment of the Group's branding in the industry will take an ever-stronger foothold, its performance will escalate and the Group will live up to its mission of becoming a leading digital animation and entertainment player in Asia demonstrating world leading innovation, quality and efficiency.

For the year ended 31st March 2004, sales attributable to the largest and the five largest customers accounted for 58.5% (2003: 18.2%) and 100% (2003: 57.8%) of the total turnover respectively. The only raw materials required by the Group's operations is digital audio tapes supplied by a few suppliers, purchase attributable to the largest and the five largest suppliers accounted for less than 1% (2003: 26.4% and 50.2% respectively) of the total cost of the year.

Other than as disclosed in note 33 of to the financial statements, none of the Directors, their respective associates (as defined in the the Rules Governing the Listing Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules")), or any shareholder of the Company (who or which, to the knowledge of the Directors, own more than five per cent of the issued share capital of the Company) has any interest in any of the Group's five largest customers and suppliers.

### LIQUIDITY AND FINANCIAL RESOURCES

The Group generally finances its operations with internally generated cash flows and banking facilities. As at 31st March 2004, the Group had available aggregate banking facilities of HK\$84.5 million of which approximately HK\$1.2 million had been utilised. The Group's cash deposits and bank balances as at that date amounted to approximately HK\$65.2 million (of which, an amount of HK\$39,800,000 were pledged bank deposits). The Board believes that the Group has sufficient financial resources to discharge its debts and finance its operations and capital expenditures.

Further, the Group has maintained a sound capital structure with a current ratio of 4.6 and a gearing ratio of 12.9% (being total liabilities to shareholders' equity) at year end date.



**FOREIGN EXCHANGE EXPOSURE**

Transactions of the Group are predominately denominated in Hong Kong dollars, US dollars, Euro and Japanese Yen. No hedging or other instruments to reduce the currency risks have been implemented during the year. However, review of the Group’s exposure to foreign exchange risk is conducted periodically and derivative financial instruments may be used to hedge against such risks when necessary.

**CHARGES ON ASSETS**

As at 31st March 2004, the Group had no charges on any of its assets.

**CONTINGENT LIABILITIES**

As at 31st March 2004, the Group had no significant contingent liabilities.

**HUMAN RESOURCES**

As at 31st March 2004, the Group has more than 270 full-time employees. The Group’s employees are remunerated according to the nature of their duties and the market trends, with incentives offered in the form of bonuses and share options based on individual performance.



**AUDIT COMMITTEE**

The Audit Committee meets regularly with the Group’s senior management and the external auditors to consider and review the Group’s financial statements (including the financial statements for the year ended 31st March 2004), the nature and scope of audit reviews, and the effectiveness of the system of internal control and compliance and to make recommendations to the Board. The members of the Audit Committee are Mr. Oh Kok Chi (Chairman of the Committee), Mr. Alexander Reid Hamilton and Mr. Randy Harris.

